BEULAH CAPITAL

# Beulah Growth Plus Portfolio

Quarterly Fact Sheet | September 2019

L3, 163 Eastern Rd, South Melb Vic 3205
T 61 3 9270 9170 F +61 3 8080 5983
W beulahcapital.com

Beulah Capital Pty Ltd
ABN 72 079 169 127
AFSL 330951

beulah

## Investment Approach

The portfolio aims to achieve a rate of return that matches inflation (CPI) plus 6% over a rolling 7 year period.

### INVESTMENT STRATEGY

The portfolio targets a 10% investment in income assets (cash and fixed income) and 90% investment in growth assets (shares, property and international) either directly or through specialist wholesale fund managers. The allocation to individual asset classes is managed on a dynamic basis and may vary within nominated ranges.

## Universe

The portfolio is mainly invested across a mix of shares and property with some diversification into fixed income securities. The targeted use of specialist managers also allows access to investment expertise and a diverse range of securities not readily available in an individual portfolio of this size.

**RISK PROFILE**
Medium to high: The estimated frequency of an annual negative return being less than 1 in 4 years.

**MINIMUM INITIAL INVESTMENT**
$100,000 on a standalone basis

**MINIMUM SUGGESTED TIME FRAME**
7 Years plus

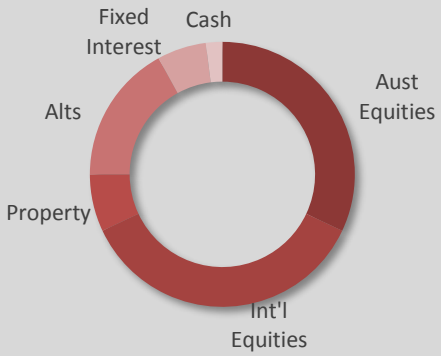
## Performance

Beulah Growth Plus Portfolio

| | 3 Month % | 6 Month % | 1 Year % | 3 Year % | 5 Year % | Incept % |
|---|---|---|---|---|---|---|
| Portfolio Return | 1.09 | 4.79 | 3.22 | 4.98 | 6.14 | 7.58 |
| Peer Returns – Aggressive | 2.23 | 6.21 | 7.11 | 7.88 | 6.96 | |
| **Relative Return** | **-1.14** | **-1.42** | **-3.89** | **-2.90** | **-0.82** | |
| Investment Objective (CPI +6) | | | | | | 8.23 |

***Performance Notes:***
*1: Peer returns are based on Morningstar Category peer averages.*
*2: Model portfolio return includes dividends and income, but does not assume reinvestment.*
*3: Returns greater than 12 months are annualised.*
*4: Returns are calculated after Managed Fund and other transaction costs, but before portfolio and MDA fees.*
*5: Returns are rounded to two decimal places.*
*6: Returns and holdings may vary between investors given the nature and timing of beneficial ownership under an MDA structure.*
*7: This document is for marketing purposes only.*
*8: Past performance is not an indication of future performance.*

## Asset Allocation




| Sector | Actual % | Range % |
|---|---|---|
| Australian Equities | 32 | 20-75 |
| International Equities | 36 | 15-70 |
| Property Securities | 7 | 0-15 |
| Alternatives | 17 | 0-35 |
| Fixed Interest | 6 | 0-15 |
| Cash | 2 | 0-20 |

## Contribution to Performance

| Company | Contribution to performance % |
|---|---|
| Australian Equities | 0.11 |
| International Equities | 0.55 |
| Property Securities | 0.02 |
| Alternatives | 0.29 |
| Fixed Interest | 0.11 |
| Cash | 0.01 |

## Market Review

The beginning of the quarter saw shares slump and gold surge as the truce in the trade war between the US and China was tempered by a fresh threat of tariffs against Europe and disappointing manufacturing data. The Eurozone PMI manufacturing survey showed the sector was continuing to contract, while US manufacturing activity was also slowing. However, investors ultimately treated this as a buying opportunity and the rally in developed market equities, listed property and bonds quickly resumed. Emerging Markets remained the key laggard, with shares in this space continuing to underperform.

August heralded the return of volatility in financial markets. President Trump's tweet that the US would impose a 10% tariff on US$300b of Chinese imports breached an earlier ceasefire agreement and clearly surprised investors. China eventually responded with retaliatory measures, to which the US announced higher tariff rates, further unsettling markets. The US also labelled China a "currency manipulator" after the Yuan fell through a crucial level. This saw capital surge into safe haven investments and out of risk assets. Emerging Markets were particularly subject to such outflows.

Later in the September quarter fixed interest began to come under pressure for the first time in a long time and the yield curve rose across most of the term structure. The bond market sell-off was sparked by soaring oil prices that came after an attack halved Saudi output. While output was quickly restored, the thought of an inflationary outbreak at a time when global growth has been slowing was enough to spook investors.

The sell-off in fixed income markets came despite another cut in US interest rates. The US Federal Reserve (the Fed) was generally quite positive in its commentary, with one commentator describing the move as a "hawkish easing". President Trump, who is now facing impeachment, launched an attack on the

Fed saying that it had "failed" in its role as central bank. However, monetary policy may not be as strong a tool as it once was to deal with crisis given there is less room to manipulate rates compared to previous easing cycles.

While global bond proxies such as property and infrastructure were relatively unscathed, quite the opposite was true for domestic peers. More broadly, equities climbed higher on renewed optimism of a trade deal, expected future cuts in US interest rates and an announcement of an easing package by the European Central Bank. The rise in equities included a rotation from growth into value and small-caps, and reversed what was a strong momentum rally in August.

Meanwhile in early September we learned that June quarter Australian GDP growth was the slowest annual rate since the GFC. Domestic spending has been quite weak, and if not for rising government expenditure and a surge in net exports it is possible Australian economic growth would be close to zero. Over the same period, Australia recorded its first current account surplus since 1975 due to a record trade surplus and narrowing in the net income deficit.

In Emerging Markets, Argentina has asked its creditors for more time to pay back some of its foreign debt to avoid a ninth sovereign default; while China's manufacturing activity rebounded in September due to improving domestic demand, but orders from overseas remained subdued. Overall, the global economy is losing momentum – led by manufacturing. Industrial production sees growth contracting faster and there is no evidence that the cycle is about to improve. Momentum is generally slowing. While this increases the prospects of a recession, this is not our base case.

## Portfolio Review

Although during the quarter the portfolio overall underperformed our peers, the Beulah investment team made some key strategic changes that delivered positive gains throughout September and more recently into October. The portfolio was re-positioned through September post reporting season with the following key thematics:

- Low interest for longer, resulting in continued support for growth investments
- Inflation likely to remain stagnant but a key risk
- Technology and healthcare related investments will continue to have structural growth opportunities throughout the world to provide growth for investments
- Private capital markets, in particular private credit will continue to provide attractive higher rates of income for the risk taken by investors
- Strategically re-positioning back into property assets as it became clearer that rates will remain low and that we may have seen the bottom of the residential property market.
- Continuing to prefer overseas investments rather Australia for core growth opportunities
- Fixed interest investment returns likely to remain low, therefore reduced exposures to fixed interest investments that are not yielding enough with such low returns
- Reduced investment in emerging markets until political certainty to some extent is restored.

During the quarter we continued to introduce some additional and new investments into the portfolio, using a combination of both direct shares, ETFs and managed funds to gain exposure to the investment themes above. Pleasingly, our recent and new positions have started off in a positive manner. Of note, we introduced some new direct shares to the portfolio with a key focus on technology and online businesses – both here in Australia and overseas. New stocks into the portfolio were Realestate.com.au, Seek.com.au and Afterpay. We introduced additional investment into Infrastructure and airport monopoly business, Sydney Airports and took the opportunity to sell out of Orora which received a healthy takeover offer for a significant portion of the business.

Although the reporting season was somewhat overshadowed by the macroeconomic factors such as the US – China trade tensions which continue to dominate headlines around the world, we were pleased to see some key stocks within the portfolio providing us with some positive news. CSL guidance was above consensus and continues to produce great returns for portfolios. Reliance Worldwide rebounded strongly following a profit warning in May. The main reason being that the details cited for the miss proved to be short term in nature and the potential customer loss wasn't as bad as feared.

# Portfolio Review (cont.)

We re-introduced property exposure via an ASX200 property ETF which is a cheap, diversified investment holding of the top REIT investments. While we also added strategic holdings in Stockland and property private debt provider Qualitas, which was increased post the introduction of the holding earlier this year.

Our overseas investments continue to increase in its overall exposure but with more specific allocations to the structural growth strategies we believe should continue, regardless of most macro-economic conditions. We introduced two new investments, the first one was a concentrated international investment fund run and managed by Franklin Global Investment Management. The international equities portfolio holds no more than 40 stocks and has a high concentration on technology hardware, software and online businesses within its portfolios. We have been following this fund and manager for many years and have a high degree of confidence that the concentrated approach will provide suitable long term returns from our offshore investments.

In addition to that, we added to the portfolio a global healthcare ETF (exchange traded fund) that is listed here in Australia. This ETF is managed by iShares and provides investors with a cost effective investment in some of the largest healthcare businesses in the world. The ETF is predominately holding the largest global healthcare businesses located in the US and Europe. The fund owns names such as Johnson & Johnson, United Healthcare Group, Novartis, Merck & Co, Roche Holdings and Pfizer to name a few. We think that this will complement our large CSL position already held in the portfolio to growth investments in the healthcare sector.

We also conducted a review into small cap investing and the opportunities we see within the Australian market. Small cap investing over recent years hasn't necessarily produced the returns given the risks being taken. Unfortunately, in Australia, IPO listings of small businesses is not occurring as often as it has in the past and those listing are not necessarily of the quality that an investor would want to invest in.

The other issue or concern we face with investing in small cap funds is capacity constraints. Managers in this space have continued to grow their funds under management to levels which may be considered prohibitive to move in and out of stocks at good prices. We are reviewing this whole sector at the moment and whether to continue with the existing holdings or look for other opportunities. We will monitor this over the next 6 months.

Several of our underperforming assets that affected our performance throughout 2018 have continued to recover at a greater rate than the market through the quarter which has continued on through October. Of note, L1 Capital's long/short fund has continued to increase its returns over the calendar year. To the 30th of September, the fund had risen over 18% and as at the time of writing this review, had added another 3% to the total return.

We also took the opportunity to reduce our exposures to the emerging market countries given the continued political uncertainty created by China, in particular the ongoing protests staged in Hong Kong. A disappointing investment in Dalton Capital was exited in the quarter in favour of clearer structural growth investments discussed above. It is always disappointing to have investments held in the portfolio that have not returned to investors the expected outcomes that you were seeking.

We anticipate that the continued re-structure of the investments throughout the past 6 months will see a much more positive return to investors above and beyond the average. We have also made some minor adjustments to existing positions where we reduced underperforming assets but have decided to hold these for the time being.

# Outlook

Following a strong rally in domestic shares and similar rises in important global indexes during the first half of this calendar year, many investors were unprepared for the spike in volatility that has greeted them in the new financial year.

An escalation of the economic "cold war" between the US and China has threatened to derail global growth. A slowdown in manufacturing and continuing weakness that began in many emerging economies, as well as in Germany, has now spread to the US, which has startled financial markets. President Trump's imposition and subsequent delay of additional rounds of tariffs has also been met with increasing trepidation. The importance of Twitter has never been so great.

With key economies losing momentum, the market panicked when the US 10 year treasury yield briefly moved below that of its 2 year equivalent. Reports in the media of an "inverted yield curve" are in fact referring to this feature. This has made headlines because it has sometimes been a harbinger for recession. At present, however, the yield curve is not inverted across these maturities.

Prior to this, the weakening of the Chinese renminbi also created shockwaves and many commentators exclaimed that it was a tactic to "weaponise" the currency. However, closer inspection by organisations such as the IMF and World Bank suggested that the devaluation was more in line with changes in fundamentals … It sometimes pays to ignore the headlines.

While we do not ignore the fact that risks to important global economies are mounting, it is worth emphasising that a recession is not currently the most likely outcome and that many data points are continuing to hold up well. The global consumer, and the US consumer in particular, is continuing to spend. The cost of borrowing is stable or decreasing. Investment is fixed assets (or 'capex') remains solid in many regions and labour markets are continuing to create jobs along with modest wage growth. In Australia, lower interest rates, the implementation of tax cuts, looser macro prudential settings and a rising infrastructure spend should benefit growth over the short term.

This is not to discount the knock-on effects of the trade war, which has hurt global manufacturing and forced businesses to re-route supply chains. As clouds of uncertainty gather, investor sentiment can quickly sour, but just as easily be restored by new policy announcements and other factors. The sell-offs in early August and early October came when markets were elevated. Given that there are ordinarily three or four sell-offs over the course of a year, this is not altogether unexpected and shouldn't be any more alarming. Forging a new high (or low) typically tests the market psyche and large swings often follow.

Problems usually arise when markets continue to fall and fear starts to grip investors – such as during the December quarter last year. But, it is quite possible that the bumpy ride in August and again in October will also be well navigated by the broader market.

Like Australia, the US has begun to cut interest rates and an easing in monetary policy is already underway in many other regions. Falling interest rates have the effect of making other yielding assets more attractive and this includes equities. Governments can also drop their ideological disdain for fiscal stimulus and make significant inroads into the output gap. Australia's budget is effectively in balance (not that this technically matters), the US does not have to deal with artificially imposed debt limits known as the "debt ceiling" for another two years, and even fiscally-conservative Germany is sending signals that it is more prepared to loosen its purse strings.

However, one would expect that more volatility is on the way. A lasting resolution to the trade war looks unlikely as the US approaches another presidential-election year. Brexit, if and when it finally occurs, will create headlines, particularly if no deal can be reached with Europe. And Hong Kong, an important global financial centre, is being crippled by anti-China, pro-freedom protests. Ominous signs of a military build-up by the Chinese near the Hong Kong border will also unsettle investors. Some see accommodative policy by central banks as encouraging a misallocation of capital, meaning that markets have further to fall should something go seriously awry.

On balance, we feel that equity investors are being rewarded for risk and that low interest rates (or discount rates) are helping justify elevated share markets. Holding a well-diversified portfolio can help buttress against market gyrations and make buying the dip a little less nerve-wracking. For investors with a long-term horizon, patience is a virtue as markets have shown a tendency to rise over the long-term.